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RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RHEHNSC/NSC WASHDC
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UNCLAS SECTION 01 OF 02 CARACAS 000741

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD
ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD

E.O. 12958: N/A
TAGS: EFIN ENRG VE
SUBJECT: PDVSA BONDS POSTMORTEM

REF: CARACAS 667

¶1. (SBU) SUMMARY: On April 12, PDVSA issued USD 7.5 billion worth of bonds. The issuance, an increase over the USD 5 billion originally offered, was divided between three securities, yielding 5.25 percent, 5.3 percent and 5.5 percent, and maturing in 2017, 2027, and 2037, respectively. The bonds were oversubscribed by as much as 300 percent, with demand driven almost entirely by Venezuelans seeking a guaranteed profit and access to dollars. The issuance is one of the largest in the history of emerging market debt issuances. END SUMMARY.

¶2. (SBU) PDVSA issued USD 7.5 billion in dollar-denominated Eurobonds on April 12 via the Venezuelan Central Bank (BCV). The issuance rose from USD 3.5 billion, discussed in early 2007, to a USD 5 billion offered on March 22 (reftel), to an announced allocation of USD 7.5 billion on April 3. As of the morning of April 13, the bonds were being sold in secondary markets at 76 percent of face value. The increased allocation was due both to high demand in Venezuela and by PDVSA's seemingly insatiable hunger for cash. With this issuance, PDSVA will have issued over USD 12 billion in 2007, raising its total debt stock from USD 4 to USD 16 billion. The proceeds (in local Venezuelan bolivars) will reportedly be used to fund PDVSA's ambitious investment plans, though local analyst and industry players think it more likely that PDVSA will use this money to pay off current liabilities stemming from the "nationalization" of the oil industry in 2006 and 2007.

¶3. (SBU) Santander Investment expects that the issuance will remove around 50 percent of the excess liquidity in Venezuela, and estimates that the USD 7.5 billion amount represents 14 percent of Venezuela's current money supply (M2). PDVSA has said previously that, to avoid reinjecting money into the local economy, it would convert the bolviars into dollars with the BCV. This would reduce the country's foreign exchange reserves by USD 7.5 billion overnight. Coupled with transfers of USD 2 billion in February and USD 1.7 billion in March to FONDEN, this would represent almost a 33 percent decrease in foreign reserves since the beginning of 2007, and leave the BCV with enough money to cover only eight months of imports (well below the stated goal of 12 months). (Note: As of April 13, the BCV had 31.4 billion in foreign exchange reserves. End Note).

¶4. (SBU) In addition, even without the potential drain of USD 7.5 billion in hard currency, the BCV's liabilities already exceed its assets. While Central Banks by definition cannot go bankrupt, the effects of the BRV's monetary policy are clearly beginning to show. Lower foreign reserves mean the BCV will have fewer resources to use for its operations and to back the CDs and notes it issues to banks locally to absorb liquidity. The BCV is also handling the on-going monetary conversion, which will remove three zeroes from the bolivar. It reportedly will cost the BCV at least USD 100 million to purchase new bills and coins.

¶5. (SBU) The announcement on April 2 provided a table of allocations. Requests below USD 3000 will receive the full amount and a sliding scale for larger requests ranges from 90 percent of orders between USD 3000 and 5000 to 20 percent for those in excess of USD 20 million (capped at USD 100 million). The bonds were reportedly oversubscribed by as much as 300 percent (which provided one of the excuses to up the ante). Given the caps on issuances, this offering will not meet the demands of many of the corporations whose dollar needs drive the parallel market rate (reftel). Following the PDVSA bonds announcement on March 22, the parallel rate fell from Bs. 4000/dollar to around Bs. 3500/dollar, where it has been hovering ever since. Most financial watchers expect it to stay in this range for the near future, barring significant changes in approvals by the Commission for the Administration of Foreign Exchange (CADIVI).

¶6. (SBU) On April 10, the BRV published an income tax exemption for the bonds in the Official Gazette. Previously, Ministers Cabezas and Ramirez had explained that the PDVSA bonds would, like sovereign debt, be tax free. However,



under Venezuelan law this was not permissible. The last minute act made possible by Chavez' diktat powers through the enabling law allowed the exemption, though the wording has led to more questions. Under the language published in the Gazette, the bonds are only tax free for five years (through 2012) and only tax free locally. Once traded on secondary markets outside of Venezuela (as almost all will be in order for their holders to obtain dollars), it appears that future owners will owe taxes to the Venezuelan government, putting a further discount on their value and further complicating an already messy issuance.

¶7. (SBU) The issuance also caused a hiccup in the banking sector, as bank liquidity was hurt when clients withdrew USD 7.5 billion to pay for the bonds on April 12. The interbank loan rate doubled (from around 7.5 percent to over 15 percent) overnight and the BCV had to inject bolivars into the system in order to prevent a crisis.

¶8. (SBU) COMMENT: The newspaper El Nacional recently estimated that only 2.6 percent of Venezuelans had sufficient savings to be able to afford the bond offering. Reportedly, brokers were in the barrios (poor neighborhoods) in the week leading up to the sale offering 500,000Bs. (or USD 232) for national identification numbers to submit additional orders. As was seen in the bonos del sur issuances, these lucky purchasers will make a nice return on their two week old investment, thanks to the gap between official and parallel exchange rates. While the BRV and PDVSA have touted the enormous interest in these bonds as evidence of the Venezuelan people's support, it really is demonstrative of their desire for dollars and to take advantage of a guaranteed profit. END COMMENT.

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